

HEADLINE: Proposed Formal Opinion Interim No. 19-0003 (Improper Contract Provisions)

SUBHEAD: The State Bar seeks public comment on Proposed Formal Opinion Interim No. 19-0003 (Improper Contract Provisions).

Deadline: June 8, 2021

Background

The State Bar Standing Committee on Professional Responsibility and Conduct (COPRAC) is charged with the task of issuing advisory opinions on the ethical propriety of hypothetical attorney conduct. In accordance with applicable State Bar policy and procedure, the committee shall publish proposed formal opinions for public comment (See, State Bar Board of Trustee Resolutions July 1979 and December 2004. See also, Board of Trustee Resolution November 2016).

On May 10, 2018, the California Supreme Court issued an order approving 69 new Rules of Professional Conduct, which went into effect on November 1, 2018. Information about the new rules is available [here](#). Proposed Formal Opinion Interim No. 19-0003 interprets the new Rules of Professional Conduct.

Discussion/Proposal

Proposed Formal Opinion Interim No. 19-0003 considers:

What are a lawyer's ethical duties when advising a client regarding the use of a contract provision in a transaction with a third party that is illegal under the law of the jurisdiction applicable to the transaction?

The opinion interprets rules 1.1, 1.2.1, 1.4, 1.13, 1.10, 1.16, 4.1, and 8.4 of the Rules of Professional Conduct of the State Bar of California; Business and Professions Code section 6068(d).

The opinion digest states: A California lawyer has a duty not to counsel or assist a client in conduct that the lawyer knows is criminal, fraudulent, or a violation of any law, rule, or ruling of a tribunal. That conduct includes the use of a contract provision in a transaction with a third party that has been found to be illegal under the law of the jurisdiction applicable to the transaction. If the lawyer knows that the provision is illegal, the lawyer should advise the client accordingly, may not recommend the use of the provision, and must counsel the client not to use it. If the client insists on the use of the illegal provision against the lawyer's advice, the lawyer may not participate in presenting the illegal provision to the third party. In that event, the lawyer may withdraw from the representation but is not required to do so. If the lawyer

concludes that the conduct is a violation of law reasonably imputable to the organization and likely to result in substantial injury to the organization, the lawyer for an organization must report the actions of the client constituent to a higher authority, unless the lawyer reasonably concludes that it is not in the best lawful interest of the organization to do so.

At its February 26, 2021, meeting, and in accordance with their procedures, COPRAC tentatively approved Proposed Formal Opinion Interim No. 19-0003 for a 90-day public comment distribution.

Any fiscal/personnel impact

None

Background material

Proposed Formal Opinion Interim No. 19-0003

Source

State Bar Standing Committee on Professional Responsibility and Conduct

Deadline

June 8, 2021

Direct comments to

Comments should be submitted using the [online Public Comment Form](#). The online form allows you to input your comments directly and can also be used to upload your comment letter and/or other attachments.

**THE STATE BAR OF CALIFORNIA
STANDING COMMITTEE ON
PROFESSIONAL RESPONSIBILITY AND CONDUCT
FORMAL OPINION INTERIM NO. 19-0003
ADVISING CLIENT ON ILLEGAL CONTRACT PROVISIONS**

ISSUES: What are a lawyer’s ethical duties when advising a client regarding the use of a contract provision in a transaction with a third party that is illegal under the law of the jurisdiction applicable to the transaction?

DIGEST: A California lawyer has a duty not to counsel or assist a client in conduct that the lawyer knows is criminal, fraudulent, or a violation of any law, rule, or ruling of a tribunal. That conduct includes the use of a contract provision in a transaction with a third party that has been found to be illegal under the law of the jurisdiction applicable to the transaction. If the lawyer knows that the provision is illegal, the lawyer should advise the client accordingly, may not recommend the use of the provision, and must counsel the client not to use it. If the client insists on the use of the illegal provision against the lawyer’s advice, the lawyer may not participate in presenting the illegal provision to the third party. In that event, the lawyer may withdraw from the representation but is not required to do so. If the lawyer concludes that the conduct is a violation of law reasonably imputable to the organization and likely to result in substantial injury to the organization, the lawyer for an organization must report the actions of the client constituent to a higher authority, unless the lawyer reasonably concludes that it is not in the best lawful interest of the organization to do so.

AUTHORITIES

INTERPRETED: California Rules of Professional Conduct 1.1, 1.2.1, 1.4, 1.13, 1.16(b), 4.1, 8.4(c).^{1/}

Business and Professions Code section 6068(d).

INTRODUCTION

Certain types of contract provisions have been found to be illegal under California law. For example, provisions in employment contracts that impair the ability of employees to compete against their employers following termination of employment have generally been found to be illegal under California law, subject to limited exceptions. See *Edwards v. Arthur Andersen LLP*

^{1/} Unless otherwise indicated, all references to “rules” in this opinion will be to the Rules of Professional Conduct of the State Bar of California.

(2008) 44 Cal.4th 937, 945 [81 Cal.Rptr.3d 282]; *Robinson v. U-Haul Co. of California* (2016) 4 Cal.App.5th 304, 309 [209 Cal.Rptr.3d 81]; Business and Professions Code section 16600. For purposes of this opinion, the Committee does not opine on whether a particular clause in a contract is illegal as this raises an issue of law; instead, the Committee confines its discussion to the ethical issues presented by the factual scenarios set forth below.

STATEMENT OF FACTS

Lawyer works for a large California corporation providing employment law advice to the Human Resources department (“HR”) responsible for all non-executive hiring. Employees hired through HR are presented with a standard form written employment agreement (“Agreement”). This Agreement is presented by HR to new hires as a non-negotiable agreement that must be signed as a condition of employment. Lawyer is tasked with reviewing and updating the Agreement, which contains a provision that has been found to be illegal under California law.

Factual Scenarios

1. Lawyer knows that the provision has been found to be illegal, but advises HR to use the Agreement anyway, without further advice or analysis.
2. Same facts, except that Lawyer does not know that the provision is illegal.
3. Same facts, except that Lawyer advises that the contract provision has been found to be illegal under California law, but does not recommend against including the provision.
4. Same facts, except that Lawyer advises that the contract provision has been found to be illegal under California law and recommends against including the provision. HR advises Lawyer that it understands the provision is illegal but would still like to include it in the Agreement for its chilling effect. HR has asked the Lawyer to assist in enforcing the provision.

DISCUSSION

A. Duty to Advise of an Illegal Contract Provision

Rule of Professional Conduct 1.2.1(a) states that a “lawyer shall shall not counsel a client to engage, or assist a client in conduct that the lawyer knows is criminal, fraudulent, *or a violation of any law, rule, or ruling of a tribunal.*” (Emphasis added.) Rule 1.2.1 is modeled in substance after former rule 3-210 but adds clarifying language derived from ABA Model Rule 1.2(d). The California rule is broader than the ABA Model Rule 1.2(d), which merely prohibits counseling or

assisting a client on conduct known to be criminal or fraudulent.^{2/} Both the California rule^{3/} and the ABA Model Rule allow a lawyer to discuss the legal consequences of any proposed course of action and counsel or assist the client in interpreting the application of any law, rule or ruling to that course of action.^{4/}

The California rule on its terms applies to every type of legal representation, including transactional work and negotiation. A lawyer cannot knowingly advise a client to propose an illegal provision in a contract that will be offered to a third party. See ABA Model Rule 1.2, Comment [10] (“The lawyer is required to avoid assisting the client, for example, by drafting or delivering documents that the lawyer knows are fraudulent or by suggesting how the wrongdoing might be concealed.”); ABA Section of Litigation, *Ethical Guidelines For Settlement Negotiations* (August 2002), at pp. 46-47) (“A lawyer should not negotiate a settlement provision that the lawyer knows to be illegal.”).^{5/}

In Scenario 1, Lawyer is knowingly recommending the inclusion of a provision that Lawyer knows is illegal in violation of rule 1.2.1(a).^{6/} Conversely, in Scenario 2, Lawyer does not know that the specific type of contract provision is illegal and, thus, does not violate the rule. However, Lawyer likely violated the duty of competence under rule 1.1(a). Knowing that the specific provision was illegal is likely to be reasonably necessary to provide competent legal advice to HR on employment law matters consistent with rule 1.2.1(b), and Lawyer’s failure to acquire such knowledge before advising the client, might be grossly negligent under rule 1.1(a). See also rule 1.1(b).

^{2/} ABA Model Rule 1.2(d): “A lawyer shall not counsel a client to engage, or assist a client, in conduct that the lawyer knows is criminal or fraudulent, but a lawyer may discuss the legal consequences of any proposed course of conduct with a client and may counsel or assist a client to make a good faith effort to determine the validity, scope, meaning or application of the law.”

^{3/} Rule 1.2.1(b): “Notwithstanding paragraph (a), a lawyer may: (1) discuss the legal consequences of any proposed course of conduct with a client; and (2) counsel or assist a client to make a good faith effort to determine the validity, scope, meaning, or application of a law, rule, or ruling of a tribunal.”

^{4/} See California State Bar Formal Opn. 2020-202, generally, for discussion on the scope of permitted advice and assistance a lawyer may provide to clients related to conduct described in rule 1.2.1(a).

^{5/} The ABA Model Rules may be looked to for guidance on proper professional conduct, particularly in areas where there is no contrary California authority or conflicting public policy. See California Rule of Professional Conduct 1.0, Comment [4] (“Ethics opinions and rules and standards promulgated by other jurisdictions and bar associations may also be considered” for guidance on proper professional conduct).

^{6/} The Committee would reach the same conclusion in all four scenarios if Lawyer was drafting the agreement *ab initio*.

B. Duty Not to Assist Enforcement of an Illegal Contract Provision

While the ABA frames this issue in terms of fraud or crime, the duty is broader in California because our variation of ABA Model Rule 1.2(d), rule 1.2.1, also adds violation of any law, rule, or ruling of a tribunal, even if those violations do not amount to a crime or fraud.

In Scenario 3, Lawyer has a duty not only to advise the client or client constituent, HR, on the interpretation of the applicable law and the possible consequences of using the provision in question, but also to recommend against its use and avoid assisting the client's enforcement of the illegal provision.

In Scenario 4, because the client or client constituent insists on including the illegal provision for its in terrorem effect contrary to Lawyer's advice, Lawyer must advise the client regarding the limitations on Lawyer's conduct, including that Lawyer will not represent the client in advocating or attempting to enforce the illegal provision. Rule 1.2.1, Comment [5]; rule 1.4(a)(4).

A lawyer may not knowingly make a false statement of law to a third person. Rule 4.1(a). Rule 8.4(c) states that it is professional misconduct for a lawyer to "engage in conduct involving dishonesty, fraud, deceit, or reckless or intentional misrepresentation." California statutory law states the duty in broader terms. See Business and Professions Code section 6068(d)^{7/} (It is the duty of an attorney "[t]o employ, for the purpose of maintaining the causes confided to him or her those means only as are consistent with truth . . ."). Accordingly, advocating or attempting to enforce an illegal provision in an employment agreement for its chilling effect on third parties would violate rule 8.4(c) and Business and Professions Code section 6068(d). See also, California State Bar Formal Opn. 2015-194, where this Committee opined that a lawyer may not knowingly make false statements of fact or implicit misrepresentations of material fact during negotiations because such statements could constitute deceit, employment of means not "consistent with truth," and dishonest conduct, all of which are ethically prohibited by Business and Professions Code sections 6106, 6128(a), and 6068(d), and related California case law.^{8/}

Traditionally, in representing a client in arm's length business negotiations, a lawyer owes a limited duty to the other side that does not include a duty to inform that party of relevant facts. "[I]n drafting an agreement or other document on behalf of a client, a lawyer does not necessarily affirm or vouch for the truthfulness of representations made by the client in the agreement or document." Rule 4.1, Comment [1]. Nonetheless, a "nondisclosure can be the equivalent of a false statement of material fact *or law* under paragraph (a) where a lawyer

^{7/} While the statute has most often been applied in the context of a lawyer's duty not to mislead the Court, relying on the second clause of the statute [citation], there is no textual limitation of the application of the first clause to transactional work.

^{8/} California State Bar Formal Opn. 2015-194 was issued prior to the time that rule 4.1 was enacted, but the Committee also relied on ABA Model Rule 4.1 in support of its argument.

makes a partially true but misleading material statement or material omission.” *Id.*; see also California State Bar Formal Opn. 2015-194.

Lawyers have less latitude to make or ratify a false statement of *law* made by the client. See South Carolina Bar Ethics Opn. 05-03 (2005) (lawyer for ex-wife sent letter to ex-husband falsely claiming that ex-husband was required under divorce decree to undergo drug testing; this conduct violated South Carolina Rules of Professional Conduct 4.1 and 8.4(c)); *In re Discipline of Attorney* (2008) 451 Mass. 131 [884 N.E.2d 450] (lawyer disciplined under Rule 8.4(c) alone for sending letters to insurers of opposing parties falsely claiming entitlement to lien on insurance payments payable to his clients). Rule 4.1(b) is limited to disclosures necessary to avoid assisting in a “criminal or fraudulent” act by a client, which is narrower than illegal conduct. However, the advocacy of a contract provision *known both by the client and the lawyer* to be illegal for its chilling effect is a fraudulent act.^{9/}

C. Lawyer May Have a Duty to Withdraw from the Representation

In Scenario 4, if HR insists on including the illegal provision, Lawyer may withdraw but is not compelled to withdraw merely because the client chooses to use the illegal provision, despite the lawyer’s admonition, even if the use of that contract provision is deemed fraudulent or even criminal. Rule 1.2.1, Comment [2]; rule 1.16(b)(1) -(3).^{10/} If, however, HR conditions Lawyer’s employment on continued participation in HR’s use of the contract provision, or enforcement thereof, Lawyer may be required to withdraw under rule 1.16(a)(2), which makes withdrawal mandatory if “the lawyer knows or reasonably should know that the representation will result in violation of these rules or of the State Bar Act,” that is, a violation of rules 1.2.1, 4.1, and 8.4 and Business and Professions Code section 6068(d).^{11/}

D. Duty to Report Up in An Organization

Because the client is an organization, in Scenario 4 Lawyer will have a duty to report the conduct of the corporate constituent (*e.g.*, HR) to the higher authority in the organization if

^{9/} Under rule 1.0.1(d): “Fraud” or “fraudulent” means conduct that is fraudulent under the law of the applicable jurisdiction and has a purpose to deceive.

^{10/} See rule 1.16 (b) (“Except as stated in paragraph (c), a lawyer *may* withdraw from representing a client if: (1) the client insists upon presenting a claim or defense in litigation, or *asserting a position or making a demand in a non-litigation matter, that is not warranted under existing law and cannot be supported by good faith argument for an extension, modification, or reversal of existing law*; (2) the client either seeks to pursue a criminal or fraudulent course of conduct or has used the lawyer’s services to advance a course of conduct that the lawyer reasonably believes was a crime or fraud; (3) the client insists that the lawyer pursue a course of conduct that is criminal or fraudulent . . .”). (Emphasis added.)

^{11/} The lawyer may not reveal confidential advice or information regarding the use of the illegal provision, except as required by rule 1.13. (See rule 1.6 and Cal. Bus. & Prof. Code § 6068(e)(1). See also Cal. State Bar Form. Opn. 2015-192, generally, for discussion on lawyer’s duty to maintain confidential information when withdrawing from a client representation.)

Lawyer knows or reasonably should know that the conduct is “(i) a violation of a legal obligation to the organization or a violation of law reasonably imputable to the organization, and (ii) likely to result in substantial injury to the organization” unless the lawyer reasonably believes that “it is not necessary in the best lawful interest of the organization to do so.” Rule 1.13(b).

Labor Code section 432.5 provides that “[n]o employer, or agent, manager, superintendent, or officer thereof, shall require any employee or applicant for employment to agree, in writing, to any term or condition which is known by such employer, or agent, manager, superintendent, or officer thereof to be prohibited by law.” Business and Professions Code section 16600 states that “every contract by which anyone is restrained from engaging in a lawful profession, trade, or business of any kind is to that extent void.” For purposes of this opinion, we assume that the contract provision is unlawful under California law. Given the possibility of substantial injury to the organization, Lawyer must evaluate carefully whether disclosure to a higher authority is reasonably necessary. (See rule 1.4 and rule 1.13, Comment [2].) Moreover, because Lawyer has a duty not to withdraw without taking reasonable steps to avoid reasonably foreseeable prejudice to the organization client. Rule 1.16(d), this disclosure must be made even if Lawyer opts to withdraw as provided by rule 1.16(c)(1) – (3).

CONCLUSION

A California lawyer has a duty not to counsel or assist a client in conduct that the lawyer knows is criminal, fraudulent, or a violation of any law, rule, or ruling of a tribunal. That conduct includes the use of a contract provision in a transaction with a third party that has been found to be illegal under the law of the jurisdiction applicable to the transaction. If the lawyer knows that the provision is illegal, the lawyer: (1) should advise the client accordingly; (2) may not recommend the use of the provision; and (3) must counsel the client not to use it.

If the client insists on the use of the illegal provision against the lawyer’s advice, the lawyer may not participate in presenting the illegal provision to the third party and may not assist the client in enforcing the provision. In that event, the lawyer may withdraw from the representation but is not required to do so.

If the lawyer concludes that the conduct is a violation of law reasonably imputable to the organization and likely to result in substantial injury to the organization, the lawyer for an organization must report the actions of the client constituent to a higher authority, unless the lawyer reasonably concludes that it is not in the best lawful interest of the organization to do so.